

SENATE BILL REPORT

SB 5373

As Reported By Senate Committee On:
Labor, Commerce, Research & Development, February 27, 2007

Title: An act relating to reporting, penalty, and corporate officer provisions of the unemployment insurance system.

Brief Description: Regarding reporting, penalty, and corporate officer provisions of the unemployment insurance system.

Sponsors: Senators Kohl-Welles, Prentice, Keiser, Franklin and Kline; by request of Employment Security Department.

Brief History:

Committee Activity: Labor, Commerce, Research & Development: 1/22/07, 2/27/07 [DPS, DNP].

SENATE COMMITTEE ON LABOR, COMMERCE, RESEARCH & DEVELOPMENT

Majority Report: That Substitute Senate Bill No. 5373 be substituted therefor, and the substitute bill do pass.

Signed by Senators Kohl-Welles, Chair; Keiser, Vice Chair; Franklin, Murray and Prentice.

Minority Report: Do not pass.

Signed by Senators Clements, Ranking Minority Member, Hewitt and Holmquist.

Staff: Jennifer Strus (786-7316)

Background: When unemployment insurance (UI) benefit overpayments are caused by a redetermination of benefits, those benefits paid cannot be collected from the claimant. Those benefit amounts are also not charged to the employer, so benefits paid that should not have been are deemed an administrative overpayment and the cost of those benefits is socialized to all employers.

Any employer who fails to file a timely tax and wage report is subject to a penalty to be determined by the Commissioner of the Employment Security Department (ESD) but not to exceed \$250 or 10 percent of the employer's quarterly contributions for each failure.

Corporations may elect not to cover their officers for purposes of UI. If the corporation elects not to cover officers, it must notify those officers in writing that they are ineligible for

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unemployment compensation benefits. If the employer fails to notify the officer of its decision not to cover officers, those officers are eligible for UI benefits.

If an employer fails to report the number of hours worked by employees during a reporting period, the number of hours will be computed by ESD based upon a formula.

A claimant is disqualified to receive benefits for any week he or she has knowingly made a false statement or representation involving a material fact or knowingly failed to report a material fact, the result of which is the claimant received benefits. The disqualification must last for 26 weeks.

A professional employer organization (PEO) generally provides human resource management functions, including employment benefits, payroll administration, workers' compensation, and unemployment insurance services to businesses. When the business contracts with the PEO for these kinds of services, the unemployment taxes paid are based on the PEO's experience rating rather than that of the client company.

Summary of Bill: Reports: Employers must include the full names and social security numbers of, and total hours worked by, each of their employees in reports to ESD. Any benefits paid using computed hours are not considered an overpayment of benefits and are not subject to collection if the correction of computed hours results in an invalid or reduced claim. However, the experience rating account of an employer who fails to report the number of hours its employees worked will be charged for all benefits paid based on computed hours. Furthermore, a reimbursable employer who fails to report the number of hours worked must reimburse the trust fund for all benefits paid that are based on computed hours.

If a UI benefit claim by an employee is later determined to be invalid because the employer failed to report or inaccurately reported the hours an employee worked, that claim will be charged to the experience rating account of the employer. A reimbursable employer who fails to report or inaccurately reported the hours an employee worked must reimburse the trust fund for all benefits paid as a result of the erroneous report.

An employer who fails to file a timely tax and wage report will be fined \$25 per violation, unless the fine is waived by the Commissioner. An employer who files an incomplete or incorrectly formatted tax and wage report will receive a warning letter for the first occurrence. For subsequent occurrences the following applies: if no contributions are due the fine is \$75 for the second occurrence, \$150 for the third occurrence, and \$250 for the fourth and subsequent occurrences; when contributions are due, for the second occurrence, the penalty is 10 percent of the quarterly contributions due but not less than \$75 and not more than \$250; for the third occurrence, the penalty is 10 percent of the quarterly contributions due, but not less than \$150 and not more than \$250; and for the fourth and any subsequent occurrences, the penalty is \$250. The Commissioner may waive any penalties if he or she determines that the employer's failure to file timely, complete, and correctly formatted reports or pay timely contributions was not the employer's fault.

Corporate Officers: The provision allowing a company to elect to cover its officers for purposes of unemployment compensation is removed.

An officer of a corporation with more than 5 percent equity or debt interest in the corporation, whose claim for UI benefits is based upon wages received from that corporation, is not

considered unemployed for any week during the officer's term of office or ownership. He or she is considered unemployed if the corporation dissolves and the officer permanently resigns or is permanently removed from his or her appointment and responsibilities with the corporation.

Upon the termination, dissolution, or abandonment of a corporation or limited liability company, any officer, member, manager or another having control or supervision of the payment of UI taxes or responsibility for filing UI reports or payments may be personally liable for unpaid UI taxes. The person is personally liable only if he or she willfully fails to pay or cause to be paid, any taxes owing. These persons are not liable if the failure to pay taxes was beyond their control as determined by ESD in rule or all the assets of the company have been applied to its debts through bankruptcy or receivership.

Employer Registration: Every employer must register with ESD and obtain an employment security account number. To register, the employer must provide the following information: the names and social security numbers of the owners, partners, members or corporate officers of the business along with their mailing address, telephone numbers, and other information required by ESD by rule. If the owners, partners, members, or officers change, the employer must notify ESD of this fact within 30 days.

Fraud: For decisions mailed after January 1, 2008, the penalties for claimant fraud are increased for the second and third time a claimant has fraudulently claimed benefits. The second time fraud occurs, the claimant is ineligible to receive benefits for 52 weeks and is also assessed a monetary penalty of 25 percent of the benefits improperly paid. For the third and subsequent offenses, the claimant is ineligible to receive benefits for 104 weeks and is assessed a monetary penalty of 50 percent of the overpaid benefits.

Professional Employer Organizations (PEOs): All PEOs must register with ESD and provide the names, addresses, and employment security account numbers of its client companies. PEOs must also notify ESD within 30 days each time a client is added or deleted.

Before a PEO can act on behalf of a client company for UI purposes, it must enter into a power of attorney or confidential information authorization. PEOs must also file separate quarterly wage and contribution reports for each client company as well as maintaining accurate payroll records for each client company. PEOs must make these records available for inspection by ESD.

The client company, not the PEO, is the employer for unemployment tax liability and the experience rating of the client company follows the client when they enter or leave a contractual relationship with the PEO.

PEOs may not have joint accounts.

EFFECT OF CHANGES MADE BY RECOMMENDED SUBSTITUTE AS PASSED COMMITTEE (Labor, Commerce, Research & Development): In the penalty portion of the bill, language is added to require that information on available technical assistance must be included in the warning letter to employers.

There are numerous changes in the corporate officer opt-out section as follows:

- 1) Public companies may exempt any number of bona fide officers provided the officer is voluntarily elected or appointed, is a shareholder who exercises substantial control in daily management and whose primary duties do not include manual labor.
- 2) A private corporation may exempt eight or fewer bona fide officers provided the officer voluntarily agrees to be exempted, is voluntarily elected or appointed, and exercises substantial control in the daily management of the corporation if he or she is a shareholder.
- 3) An opt out provision is added.
- 4) Private corporation may exempt any number of officers if all related by blood or marriage.
- 5) Mandatory coverage is required for all workers regardless of honorary titles given to workers.
- 6) Corporation must notify ESD for exemption elections.
- 7) Coverage will not be reinstated retroactively.
- 8) Bona fide officers are not considered employees of a corporation where all work of that corporation is done by corporate officers.
- 9) A corporate officer may not collect UI if he or she, or his or her family members, has a 10 percent or more ownership of outstanding stock. It is clarified that in this situation an officer cannot collect UI even if not being paid wages.
- 10) Corporate officers not covered by the above provisions can elect UI coverage if coverage is not mandatory.

A number of changes to the professional employee organizations provisions have been made as follows:

- 1) The definition of PEO recognizes a co-employment relationship with its clients.
- 2) A requirement that PEOs must ensure that its clients' companies are registered with ESD and provide their UBI number is added.
- 3) A requirement that PEOs provide the names and social security numbers of the corporate officer, owners, or LLC members of client companies is added.
- 4) PEOs are distinguished from third party payers.
- 5) The information that PEOs must provide to ESD to register with ESD and be granted co-employer statutes is clarified.
- 6) PEOs must ensure that client companies also register with ESD.

Corporate officers are liable for unpaid taxes if the officer willfully evades any contributions imposed by Title 50, willfully destroys records, willfully fails to truthfully account for or makes under oath any false statement relating to the financial condition of company.

Language is added that the employer does not include a corporation when all personal services are performed only by corporate officers unless the corporation registers with ESD and elects to provide coverage for its corporate officers.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: The changes in the bill share a common theme: efficiency, fairness, and administrative efficiency. The bill encapsulates a lot of unfinished business that bills in the last several sessions have not covered. It provides consistency across state agencies in the powers they have with certain problems in the system. With regard to corporate officers, 84 percent of the time there is no proof that these officers received notice that they would not be covered for UI purposes. As a result, they were provided benefits and the cost to do that was socialized across employers. Because there is a high business closure rate in this state and ESD has difficulty collecting taxes that should have been paid, it is important to allow ESD to be able to collect from the officers even though the business closes. This bill is not about challenging the PEO business model - it is really about consistency in the way that employers are treated. PEOs currently file separate information with both Labor & Industries and Department of Revenue; the same should apply in unemployment compensation reports.

CON: The bill would significantly alter the core business of a PEO by removing its status as an employer and replacing it with that of an agent. The bill could also call into question the ability of a PEO to sponsor other valuable benefit plans for their employees as an employer which could result in the loss of health insurance, dental coverage, life insurance, and dependent care for thousands of Washington employees. Most PEOs pay into the UI system far more than their employees claim each year. ESD said it would do a study last year of PEOs. To date it has produced nothing in writing and yet, it has proposed a bill to remedy the issues with PEOs that their study failed to substantiate. The penalty portion of the bill will hurt small businesses. What these businesses need is technical assistance from ESD as to how to properly fill out their forms, not a fine.

OTHER: There are grave concerns about the section making corporate officers liable. The current corporation law allows a court to determine whether piercing the corporate veil is appropriate. That should be the preferred method to deal with this issue. If corporations did not pay into the UI trust fund, why is ESD paying their corporate officers benefits? There should be a time limit to the penalties so if a business made mistakes one year and then again in six years, the penalties are not cumulative. Requiring another registration process is overwhelming to small business; they are required to register enough places already.

Persons Testifying: PRO: Karen Lee, ESD; Jeff Johnson, Washington State Labor Council.

CON: Jim Halstrom, National Association of Professional Employers Organization (NAPEO); Todd Cohn, NAPEO; John Heaton, Pay Plus Benefits, Inc.; Drew Thoresen, Human Resource Innovations.

OTHER: Mellani McAleenan, Association of Washington Business; Carolyn Logue, National Federation of Independent Business; Gary Smith, Independent Business Association.